


Chapter 4, Module 8 - Review

Slide 1

Chapter 4 Module 8

AMIS 211
Introduction to Financial Accounting

Professor Marc Smith



Hi everyone. Welcome back.

Let's go ahead and let's spend a little bit of time in this module kind-of reviewing some of those key concepts that we have learned about Accruals and Deferrals.

And, let's jump right into it.

Let's go to the next slide.

Slide 2

*Chapter 4 Module 8: Adjustments Summary***SUMMARY OF ADJUSTING ENTRIES**

Type of Adjustment	Account Relationship	Adjusting Entry
1 Prepaid Expense	Assets and expenses	Debit Expenses Credit Assets
2 Unearned Revenue	Liabilities and revenues	Debit Liabilities Credit Revenues
3 Accrued Revenue	Assets and revenues	Debit Assets Credit Revenues
4 Accrued Expense	Expenses and liabilities	Debit Expenses Credit Liabilities

And, on this slide (Slide 2) I have just put together a little table for you that list out the key concepts.

Let's look at this table together for a few moments.

The first thing that they list are the Prepaid Expenses—the Deferred Expenses.

Remember what these are:

The company makes a prepayment and records that as an Asset. It remains an Asset and does not become an Expense until the Asset has been used up.

So, the relationship here is one between an Asset and an Expense account.

The Adjusting Entry (AJE) always will be a debit to an Expense and a credit to an Asset account.

Your Unearned or Deferred Revenues follow a similar logic, except in this case, the company has received cash in advance before performing some type of service.

The receipt of cash in advance is considered a Liability. We now owe the service as soon as we take the cash.

We have a Liability; it does not actually become a Revenue until we do the work and we earn it.

So, the relationship is one between a Revenue and a Liability account.

And, the Adjusting Entry (AJE) will always be: a debit to the Liability—Unearned Revenue—and a credit to your Revenue account.

Those are your Deferrals.

There is an exchange of cash first; action later.

The next two are the Accruals.

Accrued Revenues are when the Revenue is recorded first and the exchange of cash happens later.

In this case, we have earned the Revenue; we just have not gotten the cash yet.

Making Sales On Account is: a good example.

The relationship is one between an Asset—some type of a Receivable, money owed to us—and a Revenue account.

The Adjusting Entry (AJE) will always be a debit to that Receivable—an Asset—and a credit to the Revenue.

Finally, we have our Accrued Expenses.

These are expenses that have been incurred prior to the exchange of cash.

In this case, we need to record the Expense and reflect a Liability. Because: we have not paid any cash but we now owe the cash.

So, the relationship is between an Expense and a Liability account.

And, the Adjusting Entry (AJE) will always be a debit to the Expense and a credit to the Payable, or Liability, account.

I think you will find this table helpful, as you are getting the key concepts of Adjusting Entries (AJEs), Accruals, and Deferrals down.

Let's go ahead to the next slide.

Slide 3

Chapter 4 Module 8: Adjustments Summary

Which of the following statements concerning accrual-basis accounting is incorrect?

- a. Accrual-basis accounting follows the revenue recognition principle.
- b. Accrual-basis accounting is the method required by generally accepted accounting principles.
- c. Accrual-basis accounting recognizes expenses when they are paid.
- d. Accrual-basis accounting follows the matching principle

And, I have a question for you:

I want to see if you can answer this question:

Here is what the question is:

Which of the following statements concerning accrual-basis accounting is incorrect? Which of these four (a, b, c, or d) is NOT a true statement?

And, here is what the four (4) statements are:

- a) Accrual-basis accounting follows the Revenue Recognition Principle.
- b) Accrual-basis accounting is the method required by GAAP.
- c) Accrual-basis accounting recognizes expenses when they are paid.
- d) Accrual-basis accounting follows the Matching Concept.

Which of those four (a, b, c, or d) is NOT A TRUE statement?

Pretend we are on an Exam and this is the question:

Which of these four (4) is NOT TRUE?

How are we going to answer?

I would like you to think about it for a second and see if you can come up with an answer first.

And then, I want you to go to the next slide.

Slide 4

Chapter 4 Module 8: Adjustments Summary

Which of the following statements concerning accrual-basis accounting is incorrect?

- a. Accrual-basis accounting follows the revenue recognition principle.
- b. Accrual-basis accounting is the method required by generally accepted accounting principles.
- c. Accrual-basis accounting recognizes expenses when they are paid.
- d. Accrual-basis accounting follows the matching principle

And, let's go through it together.

Letter a: Accrual-basis accounting follows the Revenue Recognition Principle.

Yeah, that is true, right?

The Revenue Recognition, or Realization Principle, is one of the foundations of Accrual Accounting.

Okay, letter b: Accrual-basis accounting is the method required by GAAP.

This is also true.

That is GAAP. A GAAP is Accrual Accounting.

That is not the correct answer. That is a correct statement. Take that away.

So, we are left with two of them.

Which of those two is also a TRUE statement?

Which of those two would thus not be the answer to this question?

It is letter d, right?

Accrual-basis accounting most certainly follows the Matching Concept!

So, the statement that was INCORRECT was: letter c:

Accrual-basis accounting recognizes expenses when cash is paid.

That is: FALSE!

Accrual-basis accounting says to record revenues and expenses independent of cash in and cash out.

Okay, this was just a little self-test there.

Go ahead to the next slide.

Slide 5

Chapter 4 Module 8: Accounting Cycle

Accounting Cycle – Basic Steps:

- 1. Record transactions in the journal**
- 2. Post from the journal to the ledger**
- 3. Prepare an unadjusted trial balance**
- 4. Record and post year-end adjusting entries**
- 5. Prepare an adjusted trial balance**
- 6. From the adjusted trial balance, prepare financial statements**

And, let's go back to our Accounting Cycle.

We have talked about just about all of these steps except the one there (on Slide 5) in blue; and we will spend a minute or two on this one.

But, just to review:

The Basic Accounting Cycle:

Step 1): Record transactions in the Journal.

Step 2): Post them to the T-Accounts or the Ledger.

Once you have done that:

Step 3): Prepare an Unadjusted Trial Balance.

After that is done:

Step 4): Record and post your Adjusting Entries (AJEs).

We have spent a lot of time doing Adjusting Entries (AJEs) in this chapter.

The one step here that we have not focused on is:

Step 5: Prepare an Adjusted Trial Balance.

And, let's go to the next slide.

Slide 6

Chapter 4 Module 8: Adjusted Trial Balance

- **An adjusted trial balance is prepared after all adjusting entries have been journalized and posted.**
- **Its purpose is to prove the equality of the total debit and credit balances in the ledger after all adjustments have been made.**
- **It is the same thing as the unadjusted trial balance (a listing of accounts with their balance – see chapter 3 module 7) except it includes the effects of adjusting entries.**
- **Financial statements can be prepared directly from the adjusted trial balance.**

And, let's spend a couple of minutes with this Adjusted Trial Balance.

The Adjusted Trial Balance (Key Point #1) is done after we record and post Adjusting Entries (AJEs).

So, you do your Adjusting Entries (AJEs). You put those into your Journal. You post them over to your Ledger.

And then, prepare your Adjusted Trial Balance.

The purpose of the Adjusted Trial Balance:

It is the same as the Unadjusted Trial Balance.

It is to ensure that debits equal (=) credits—in this case, after all adjustments have been made.

It is the same idea.

We want to make sure that debits (=) credits now that we have included these Adjusting Entries (AJEs).

Another key point of the Adjusted Trial Balance is the same thing as the Unadjusted Trial Balance:

It is just a listing of the accounts with their balances to ensure that total debits equal (=) total credits.

The only difference is the Adjusted Trial Balance includes the effects of the Adjusting Entries (AJE). That is it.

Other than that: they are the exact same thing: a listing of accounts with their balances.

The Adjusted Trial Balance, of course, includes the effects of year-end adjustments.

Finally, from the Adjusted Trial Balance, we can do the next step in the Accounting Cycle.

And, that is:

Step 6): We can prepare Income Statements, Owners' Equity Statements, and Balance Sheets—the Financial Statements.